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THE FEDERAL VALUATION ACT.

The meaning of valuation is elusive. Economists do not agree upon its definition, and the Supreme Court of the United States has observed concerning it an attitude of reticence and watchful waiting. Many state commissions agree that valuations must differ with the purpose for which they are made.¹ And it is declared that valuation for rate regulation is different from valuation for taxation, or condemnation, or capitalization. In the authority cited,² it is said value may signify, (1) Inherent utility, or value in use, (2) cost of production, or normal value, (3) purchasing power, or exchange value. And elsewhere value has been defined as "state of mind".³

The importance of a satisfactory and authoritative definition looms large when we consider the issue already raised between the carriers and the state commissions. To state it roughly the carriers contend value should be determined by the present reproductive cost, and the state commissions contend it should be determined by the original cost. The difference in theories makes a difference of eight billion dollars in railway valuation.

The problem is not confined to this simple issue. It embraces or rather branches into the questions of unearned increments,

¹Whitten, Valuation of Public Service Corporations (Supp. 1914), c. 1 and citations.

²At p. 799.

³ "Value as used in the Valuation Section cannot mean value in the sense in which the word is used in condemnation and tax cases.

Value as used in the Valuation Section does not refer to market value, exchange value, or economic value.

Any findings made should be limited to the purposes for it is evident the findings are to be *prima facie* evidence, viz.: rate making, rate enforcing and rate testing."

Summary of Brief of Oregon Public Service Commission, Utilities Magazine, Vol. 1, No. 4, at p. 26.

betterments, and donations. Is the public to pay a return upon these items? To what extent is a public utility a trustee?

These problems may be simplified if we look first to the origin of valuation as an element in rate proceedings, second, when it is an element, and third, what weight it bears.

The Valuation Act⁴ provides that final valuations by the commission "shall be prima facie evidence of the value of the property" in all proceedings under the Act to Regulate Commerce, and in all judicial proceedings for the enforcement of the act or to set aside and enjoin any order of the commission. The proceedings under the Act to Regulate Commerce in which valuation is relevant are proceedings concerning rate regulation.

The commission's findings of valuation, therefore, have a probative value in two classes of proceedings:

(1) In matters of rate regulation before the commission.

(2) In enforcing or suspending in the courts the commission's orders based thereon.

The commission's function is to enforce reasonable and non-discriminatory rates. What constitutes reasonable rates is a broad field of inquiry. Many elements enter into reasonableness. They have been grouped into two main factors, the cost of service to the carriers, and the value of the service to the shipper. And many elements have been approved as entitled to consideration by the Supreme Court.⁵ But these elements have no fixed weight. Their influence as ingredients upon the final solution is variable, dependent upon each other, and the particular circumstance of each case. Value of the carrier's property is one of many elements in the factor-cost of service.

It is not determinative of the factor. And the factor itself is not determinative of the reasonableness of rates. But value exercises a function when the cost of service is being determined. And it should be properly considered and weighed in this part of the problem of reasonableness.

Value has a separate and distinct role in considering rates from another standpoint. Are they confiscatory?

The rate structure must yield a revenue which is a fair return upon the value of the property used.⁶ Value here serves another

⁴Act of March 1, 1913, c. 92, § 19a, Fed. Stat. Ann. (Supp. 1914) 204, 206.

⁵Reasonable Rates, 15 Michigan Law Rev. 478, and cases cited there.

⁶*Smyth v. Ames* (1898) 169 U. S. 466, 18 Sup. Ct. 418.

purpose. It has a function different from that it performs as an element in the reasonableness of rates. It is in the application of the above maxim that valuation becomes a real force.

It is misleading to speak of valuation as a basis for rates. Rates are not made from a basis of the value of the carriers' property. The carriers do not know the revenue each rate produces. Theoretically each rate has a cost of service and a revenue producing power, but only theoretically. Railway accounting has not progressed so far.

A whole rate structure produces a known sum; and an average cost of service, in units of ton-miles, or car-miles, may be estimated. But it is obvious that rates on different commodities vary above and below the average.

Any single commodity may not be segregated and a rate therefor imposed that is less than the cost of service.⁷ But here the test is the operating cost, or expenditures, and the valuation of the property is not a factor. Certainly a fractional revenue over cost produced by a prescribed rate might sustain the reasonableness of the rate.

It is evident, therefore, that valuation (in its last described function) becomes relevant only when an entire rate structure is under consideration, and not when single rates are in question. Confiscation, because there is not a fair return, cannot be plead unless the entire revenue of the carrier is in issue. Valuation in its function of limitation is not present in considering single rates.

"There is a wide difference in the character of testimony required to test the reasonableness of an entire schedule of rates covering the whole traffic of a particular carrier and that required to test the reasonableness of a rate on a particular commodity between two definite points. Whether an attack upon an entire schedule of rates is well founded or not is to be determined largely by ascertaining whether the gross amount of traffic carried on those rates affords the carrier, above its operating expenses and taxes, a reasonable return upon the fair value of its property. But whether it lies within the possibilities of some system of accounts that may be devised, and that is strongly denied by eminent writers on railway problems, certainly the present state of the science of railway accounting does not enable us upon any such basis to fix with certainty a rea-

⁷*Northern Pacific Ry. v. North Dakota* (1915) 236 U. S. 585, 35 Sup. Ct. 429, and see review of former cases.

sonable rate upon a particular commodity between two points.”⁸

“This Commission is called upon to deal with rates as they exist, and in so doing we ordinarily consider them, not from the revenue standpoint, but rather from the commercial and traffic standpoint.”⁹

The double function of valuation should be kept in mind. As a constructive force in the reasonableness of rates, by reason of its weight in the factor-cost of service, valuation is not controlling. As a limitation upon the rate-making power, marking a minimum below which is confiscation, valuation is controlling. In the first role it plays a minor part. In the second, it is the whole defense of the commission when the carriers cry confiscation.

The commission has reported about eight thousand decisions in rate cases. During the twenty-nine years of its existence the number of cases in which valuation was a limitation has been less than ten. But it is to be noted that in these cases all the rates of the carrier and all the rates of a certain territory are in question, and the cases if few in number are far reaching in effect.

Let us examine the meaning of valuation, and the function it performs, when the constitutional question arises as to deprivation of property.

This deprivation of property may be brought about in two ways:

(1) The revenue derived from the rates prescribed may be less than the operating expenditures. In this event, the property is whittled away year by year, and total deprivation, while gradual, is not less inevitable. (2) The revenue derived from the rates prescribed may yield so small a margin above operating expenditures, that, (a) the corpus of the property is by this process being confiscated by rendering it unattractive or even impossible to sell, and therefore valueless, or (b) the owners are deprived of their property rights of a return upon investments.

In the first kind of deprivation above described, valuation is not a factor. If the revenue is less than operating expenses

⁸*Frye & Bruhn v. Northern Pacific Ry.* (1908) 13 I. C. C. 501, at pp. 507, 508. See *Corn Belt Meat Producers' Association v. C., B. & Q. Ry.* (1908) 14 I. C. C. 376, 394; *Stonega Coke & Coal Co. v. L. & N. R. R.* (1916) 39 I. C. C. 523, 541.

⁹*Advance in Rates—Eastern Case* (1911) 20 I. C. C. 243, at p. 248. See *Atchison, T. & S. F. Ry. v. United States* (Com. Ct., 1913) 203 Fed. 56, 59.

neither a valuation of ten dollars nor ten million dollars would effect the result. There would be deprivation.

In the second kind of deprivation, valuation is a factor. For to ascertain a fair return, we must have a valuation. But when we speak of valuation for this purpose, it is at once evident that valuation has a clear and unmistakable legal intent. It is the measure of property. Property, of which no citizen may be deprived, "is everything which has an exchangeable value".¹⁰ To determine if there has been deprivation of property, a measure of the property is necessary, and that measure is exchangeable value.

Valuation for rate regulation, therefore, has no concern with economic theories when it is performing this function of limitation. It is market value or exchange value, expressed in dollars and cents. It is exactly the same kind of value that must be proved in actions of contracts and torts. It is the same kind of value a plaintiff must prove to enable him to recover for the untimely death of a cow that has strayed on a railroad right of way.

"In determining the value of land appropriated for public purposes, the same considerations are to be regarded as in a sale of property between private parties. The inquiry in such cases must be what is the property worth in the market, viewed not merely with reference to the uses to which it is at the time applied, but with reference to the uses to which it is plainly adapted; that is to say, what is it worth from its availability for valuable uses."¹¹

There remains the question of the property. Has the carrier the same kind of property in lands, rails, franchises and equipment that a citizen possesses?

This is a far more difficult question. It has been contended that carriers have only a special property in their holdings devoted to public use.¹² Another distinction has been made as to free property and property subject to regulation.

"Free property is to be valued at its value for any legal purpose. Public-utility property, on the other

¹⁰*Slaughter-House Cases* (1872) 83 U. S. 36, *per* Mr. Justice Swayne in dissenting opinion at p. 127.

¹¹*Boom Co. v. Patterson* (1878) 98 U. S. 403, at pp. 407, 408. See *L. & N. R. R. v. Barber Asphalt Co.* (1905) 197 U. S. 430, 25 Sup. Ct. 466; *C. B. & Q. R. R. v. Chicago* (1897) 166 U. S. 226, 17 Sup. Ct. 581.

¹²*United States v. Chandler-Dunbar Co.* (1913) 229 U. S. 53, 33 Sup. Ct. 667.

hand, is not to be valued for fixing rates, for any other purpose than that to which it is dedicated, and much property is not to be valued at all, so long as the property is to remain in the public service. If the owner wants full value (with all its speculative chances) for a public utility, he must first discontinue his public service and devote the property to private use."¹³

The carriers cite with enthusiastic approval the *dictum* of the Court in *The Minnesota Rate Cases*:¹⁴

"The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law."

and also *Willcox v. Consolidated Gas Co.*, where it was said:¹⁵

"If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase."

But looking beyond this question let us suppose there has been a correct and proper valuation of the property of the carrier. Do the rates yield a fair return?

How shall a fair return be analyzed? No hard and fast rule can be prescribed. It is a field for discretion as broad as the field of inquiry into the reasonableness of rates.

It has been rather generally conceded since the decision of the Supreme Court in *Smyth v. Ames*,¹⁶ that it is an absolute essential of rates that they must yield an adequate return upon the value of the property. This is not an absolute right the carriers may demand, enforceable at the expense of all other rights and persons. In the summing up of principles laid down in that case Mr. Justice Harlan said:¹⁷

"A state enactment, or regulations made under the authority of a state enactment, establishing rates for the transportation of persons or property by railroad that will not admit of the carrier earning such

¹³John H. Gray, *How Does Industrial Valuation Differ from Public-Utility Valuation?*, *Utilities Magazine*, Vol. 2, No. 1, at p. 33.

¹⁴(1913) 230 U. S. 352, at p. 454, 33 Sup. Ct. 729.

¹⁵(1909) 212 U. S. 19, at p. 52, 29 Sup. Ct. 192.

¹⁶*Supra*, footnote 6.

¹⁷At p. 526. The italics are the author's.

compensation as under all the circumstances is just to it and to the *public*, would deprive such carrier of its property without due process of law * * *."

The earlier doctrine announced in *Covington, etc., Turnpike Co. v. Sandford*,¹⁸ has been neglected, perhaps, but not utterly abandoned.

"The public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends. * * * If a corporation cannot maintain such a highway and earn dividends for stockholders, it is a misfortune for it and them which the Constitution does not require to be remedied by imposing unjust burdens upon the public."

The later cases following *Smyth v. Ames*¹⁹ on this question, *Northern Pacific Ry. v. North Dakota*,²⁰ *Norfolk & Western Ry. v. West Virginia*,²¹ and *The Minnesota Rate Cases*,²² have not denied the factor-value of the service to the public.

If the return upon the property were the only factor in rate-making, the problem would be simple. But it must be considered in combination with that equally potent factor, the value of the service to the public. Here are two conflicting and opposing elements constantly tending to neutralize or restrict each other. And the fairness of one depends upon the other, so that no formula can be followed blindly.

It leads us back into that familiar inquiry—the reasonableness of rates. A fair return may by force of circumstances be a fraction of one per cent.

As a practical matter, then, valuation may not greatly influence rates. Once the revenue exceeds by any margin the expenditure, valuation becomes an element to be considered, but one of many.

It must also be borne in mind that inasmuch as valuation is material only when the rate structure as a whole is under consideration, there is a further limitation upon its effect because the rate structure of one carrier is never considered separately. Rate structures are increased or decreased by territories because of

¹⁸(1896) 164 U. S. 578, at pp. 596, 597, 17 Sup. Ct. 198.

¹⁹*Supra*, footnote 6.

²⁰*Supra*, footnote 7, at p. 599.

²¹(1915) 236 U. S. 605, 35 Sup. Ct. 437.

²²*Supra*, footnote 14.

competition. It is obvious that an increase granted one carrier would be ineffective if other carriers in the same competitive territory were not granted similar increases.

This brings forth another problem in rate-making. The competitive carriers use property returns upon which at equal percentages would result in wide variations of rates. There follows a condition analogous to the marginal utility theory of rent—the rates are governed by the carriers whose earnings are lowest, and this means those carriers unwisely planned, unskillfully built and inefficiently operated.

The Interstate Commerce Commission has in the past adopted a plan of grouping the carriers in certain territory into classes, and has prescribed rates on the returns of the average class.²³ And such a grouping and averaging of the returns is necessary because of competition. But this emphasizes the remoteness of valuation in its effect upon rates.

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²³1915 Western Rate Advance Case (1915) 35 I. C. C. 497, at p. 560; Bituminous Coal to C. F. A. Territory (1917) 46 I. C. C. 66, 115.